No. 83-614

In the Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION, PETITIONER

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS

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QUESTIONS PRESENTED

1. Whether the Board of Governors of the Federal Reserve System properly determined that a company that executes orders to buy and sell securities solely for the account of customers and not for its own account is engaged in an activity "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act of 1956, 12 U.S.C. 1843(c)(8).

2. Whether the Board of Governors correctly concluded that a company that executes orders to buy and sell securities solely for the account of customers and not for its own account is not engaged principally in the "issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of Section 20 of the Glass-Steagall Act, 12 U.S.C. 377.

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OPINIONS BELOW

The opinion of the court of appeals (J.A. 157a-176a) is reported at 716 F.2d 92. The order of the Board of Governors of the Federal Reserve System (J.A. 125a-156a) is reported at 69 Fed. Res. Bull. 105. The Recommended Decision of the administrative law judge (J.A. 5a-122a) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on July 15, 1983, and amended on September 20, 1983. The petition for a writ of certiorari was filed on October 13, 1983, and was granted on January 23, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant statutory provisions are set forth at J.A. 177a-184a.

STATEMENT

Section 4(c)(8) of the Bank Holding Company Act of 1956 (the Act), 12 U.S.C. 1843(c)(8), authorizes the Federal Reserve Board to permit bank holding companies, as defined therein,[1] to engage directly or through subsidiaries in nonbanking activities if the Board determines by order or rule that the activity is "so closely related to banking as to be a proper incident thereto." The Board's determination that an activity is "closely related to banking" and thus is permissible for bank holding companies generally, does not, by itself, authorize any particular bank holding company to engage in that activity. The Board must also determine whether the public benefits reasonably expected to result from performance of the activity by the particular holding company outweigh any possible adverse effects. See *Board of Governors* v. *Investment Company Institute* (*ICI II*), 450 U.S. 46, 56 & n.22 (1981); see Regulation Y, 49 Fed. Reg. 794,824 (1984), to be codified at 12 C.F.R. 225.23(a). In addition, the Board may not approve the application if the activity is one barred to bank affiliates by Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, which proscribes, as a principal business, the "issue, flotation, underwriting, public sale, or distribution" of securities.

1. On February 8, 1982, BankAmerica Corporation (BankAmerica), a bank holding company within the meaning of the Bank Holding Company Act, applied to

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[1] A "bank holding company" is defined in Section 2(a)(1) of the Bank Holding Company Act of 1956, 12 U.S.C. 1841(a)(1), as "any company which has control over any bank or over any company that is or becomes a bank holding company * * *." Section 2(a)(2) of the Act, 12 U.S.C. 1841(a)(2), provides that "[a]ny company has control over a bank * * * if [inter alia] the company * * * owns, controls, or has power to vote 25 per centum or more of any class of voting securities of the bank * * *." At the time of the Board's order, BankAmerica controlled one bank, Bank of America N.T. & S.A., San Francisco, California (J.A. 127a).

the Federal Reserve Board pursuant to Section 4(c)(8) of the Act for permission to acquire The Charles Schwab Corporation and its wholly-owned brokerage subsidiary, Charles Schwab & Co., Inc. (Schwab) (J.A. 11a). Schwab is a "discount" securities brokerage firm; it effects purchases and sells securities solely on the order and for the account of customers (J.A. 17a-19a, 127a). Unlike traditional brokerage firms, Schwab does not make a market for, deal in, or underwrite securities. Schwab generally charges commissions on the securities transactions it executes for its customers at rates significantly lower than the commissions charged by full-line brokers, which ordinarily include investment advice as part of their fees (*ibid.*).[2] After the acquisition, Schwab remains a separately incorporated broker, registered with the Securities and Exchange Commission pursuant to Section 15 of the Securities Exchange Act of 1934, 15 U.S.C. 78o.

The Board published notice of BankAmerica's application and requested comments from the public (47 Fed. Reg. 16104 (1982)). Comments on the application were received from 99 sources. The Comptroller of the Currency and the Department of Justice both submitted comments supporting the proposal (J.A. 125a). Petitioner, a trade association representing over 90% of the securi-

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[2] From their inception, the nation's stock exchanges prohibited their member brokers from charging commissions at rates lower than those set by the exchanges. See generally, *Gordon* v. *New York Stock Exchange*, 422 U.S. 659, 663-672 (1975). Effective May 1, 1975, the SEC prohibited the fixing of commission rates thereby allowing competition among brokerage firms in the rates they charge. *Id.* at 673-682. Under fixed rates customers paid a single commission fee regardless of whether they received the investment research and other services for which the fixed fee was designed to compensate brokers. The initiation of competitive commission rates has permitted brokers to match fees to the services actually provided to the customer. See SEC, *Fifth Report to Congress on the Effect of the Absence of Fixed Rate of Commissions* 11, 47-50 (1977).

ties firms in this country, objected to the proposed acquisition and requested a formal hearing on the application. The request was granted by the Board and a formal hearing was held before an administrative law judge in September 1982.[3]

2. On November 12, 1982, the Administrative Law Judge (ALJ), on the basis of an exhaustive administrative record, issued a 164-page Recommended Decision, recommending that the Board approve BankAmerica's application (J.A. 5a-124a). The ALJ concluded that the Glass-Steagall Act does not prohibit a bank holding company from engaging in discount brokerage activities by acquiring a discount broker, such as Schwab (J.A. 67a-76a). In addition, the ALJ found that Schwab's discount brokerage and related activities are "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act (J.A. 76a-87a), and that, as required by Section 4(c)(8), BankAmerica's acquisition of Schwab would result in public benefits that outweigh any adverse effects from the proposal (J.A. 87a-118a).

The Board approved BankAmerica's application to acquire Schwab, adopting with only minor modifications the ALJ's Recommended Decision (J.A. 125a-156a). The Board first concluded that Schwab's discount brokerage and related activities are so closely related to banking as to be a proper incident thereto within the meaning of Section 4(c)(8) (J.A. 128a-133a). The Board found that many banks provide securities brokerage services (J.A. 129a). Although Schwab's activities differ somewhat from the services usually performed by banks, primarily because Schwab executes orders directly on stock exchanges, the Board found that banking services in connection with securities generally and Schwab's activities in particular were strikingly similar and moreover

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[3] The Chief Administrative Law Judge of the Federal Trade Commission presided at the hearing, pursuant to the provisions of 5 U.S.C. 3344.

that banking organizations are particularly well equipped to engage in the type of automated brokerage activities in which Schwab specializes (J.A. 129a-132a).

In addition, as required by Section 4(c)(8), the Board found that BankAmerica's proposed acquisition of Schwab could reasonably be expected to produce public benefits in the form of increased competition, convenience, and efficiency in the provision of retail brokerage services. The Board found on the other hand that the acquisition would cause no significant adverse effects, such as undue concentration of resources, or decreased or unfair competition with traditional brokerage firms (J.A. 133a-146a).

Finally, the Board concluded that since Schwab effects securities transactions only as agent for retail customers and not for its own account, Schwab is not engaged in the "issue, flotation, underwriting, public sale, or distribution" of securities within the meaning of Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, which prohibits members of the Federal Reserve System from being affiliated with an organization engaged principally in such activities. Therefore, the Board concluded that BankAmerica's proposed acquisition of Schwab would not result in an affiliation barred by Section 20 (J.A. 147a-153a). In response to petitioner's contention that Schwab's activities are not permissible under Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, the Board stated that Section 16 by its terms does not apply to the activities of bank holding companies; it is limited to banks. Moreover, the Board noted that Section 16 permits banks to purchase and sell securities and stock without recourse, solely upon the order, and for the account of, customers, and that the Comptroller of the Currency has interpreted Section 16 as authorizing national banks to engage in retail securities brokerage (J.A. 149a-151a).

3. The court of appeals affirmed the Board's order (J.A. 157a-176a). On the issue of the meaning of Section 20 of the Glass-Steagall Act, the court of appeals

agreed with the Board's conclusion that Schwab's brokerage services do not constitute the "public sale" of securities (J.A. 161a-169a). The court reasoned that Section 20 refers only to activities in connection with the widespread marketing of securities as principal and not to the type of retail brokerage transactions Schwab executes for its customers (J.A. 161a). The court of appeals found support for this interpretation in the Board's longstanding construction of language identical to Section 20's contained in Section 32 of the Glass-Steagall Act, 12 U.S.C. 78, which the Board interpreted as not including mere brokerage activities (J.A. 162a-163a). Moreover, the court of appeals found that the Board's reading of Section 32 had been implicitly approved by this Court in *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441 (1947) (J.A. 160a-163a). The court rejected petitioner's contention that Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, which limits a national bank to "purchasing and selling" securities "without recourse" upon the order and for the account of customers, and not for its own account, implicitly imposes restrictions on bank affiliates identical to those it expressly imposes on banks (J.A. 167a-169a).

The court also agreed with the Board's holding that Schwab's brokerage activities satisfy the "closely related" test of Section 4(c)(8) of the Bank Holding Company Act (J.A. 169a-175a). The court upheld as "clearly" supported by substantial evidence the Board's findings that banks "widely buy and sell securities for the accounts of their customers, and have become skilled in securities trading" (J.A. 171a-172a). The court rejected petitioner's contention that the Board had applied the wrong legal standard by not requiring that the proposed non-banking activity actually "facilitate" some preexisting banking operations for all banks. The court of appeals held that this Court's decision in *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46 (1981), implicitly rejected petitioner's strict "facilita-

tion" argument by focusing on the relationship between the nonbanking activity at issue and traditional banking practices (J.A. 173a-174a). Finally, the court of appeals rejected petitioner's challenge to the Board's findings that "the public benefits reasonably to be expected from [BankAmerica's] acquisition of Schwab will outweigh the possible adverse effects" (*id.* at 175a-177a).

SUMMARY OF ARGUMENT

I A.

The language and structure of Section 4(c) of the Banking Holding Company Act of 1956, 12 U.S.C. 1843 (c), indicate clearly that Congress delegated to the Federal Reserve Board broad authority to use its experience and knowledge in deciding what types of nonbank activities are "so closely related to banking" that they may properly be performed by bank holding companies directly or through nonbank subsidiaries. Congress, in the 1970 amendments to Section 4(c)(8), made plain its intention to invest the Board with "maximum flexibility" to make decisions under that provision. 116 Cong. Rec. 42432 (1970) (quoted in *Board of Governors* v. *Investment Company Institute* (*ICI II*), 450 U.S. 46, 58 n.23 (1981)). Congress recognized that the Board's expertise in financial matters makes it uniquely suited to assure that banks and bank holding companies can engage in new types of banking-related services or opportunities in order to satisfy the financial needs of the public. Nothing in the Act or its history supports petitioner's claim that the Board must disapprove a bank holding company's application to pursue a new business opportunity, even though the proposed activity has a close operational and functional similarity to the activities of banks and banks are particularly well suited to perform that function.

B.

The Board's analysis of the relationship between discount brokerage services and banking in this case is indistinguishable from this Court's analysis in *ICI II*, *supra*, of the relationship between operating and managing a closed-end investment company and traditional banking activities. This Court noted that the proposed activity was "not significantly different from the traditional fiduciary functions of banks." 450 U.S. at 55. Similarly, Schwab's brokerage services as agent for its clients are virtually identical to a variety of banking services.

Nor has any court of appeals that has interpreted Section 4(c)(8) attempted arbitrarily to cabin the Board's discretion by requiring it to show some nexus between a proposed activity and banking that is closer than the "operationally and functionally similar" test consistently adhered to by the Board since 1970. See, e.g., *National Courier Ass'n* v. *Board of Governors*, 516 F.2d 1229 (D.C. Cir. 1975). Those courts and the Board have found that this approach is well suited to the judgmental task of deciding whether a particular nonbank activity will serve the public's needs, while still maintaining the line Congress drew between banking and commerce.

C.

The fundamental flaw in petitioner's challenge to the standard applied by the Board is that it diverts attention from the real issues before the Court, viz., whether, regardless of what words are used to describe the relationship, the Board has "articulate[d] the ways in which banking activities and the proposed activities are assertedly connected" and whether it is rational to conclude that the connection is close. *National Courier Ass'n* v. *Board of Governors*, 516 F.2d at 1237. There can be no doubt that the Board's findings satisfy that standard in this case; banks have been purchasing and selling securi-

ties for their customers' accounts for decades and are undeniably well equipped to perform the type of brokerage activity Schwab specializes in. The Board's decision to approve BankAmerica's application is therefore proper under Section 4(c)(8) of the Bank Holding Company Act.

II A.

The Glass-Steagall Act contains only one provision that is relevant to the securities activities of bank holding companies and their nonbank subsidiaries; Section 20, 12 U.S.C. 377, prohibits them from engaging "principally in the issue, flotation, underwriting, public sale, or distribution" of securities. On its face, it is plain that this provision is directed exclusively at the widespread marketing of large blocks of securities to the public.

Congress was not concerned with mere brokerage transactions when it adopted Section 20 of the Glass-Steagall Act in 1933. It was responding to the underwriting activities of bank securities affiliates in the 1920's that created the speculative investments that in turn consumed so much of bank depositors' money and caused banks to fail when the securities market collapsed. S. Rep. 77, 73d Cong., 1st Sess. 8 (1933); 77 Cong. Rec. 3954 (1933). Executing stock transactions by itself did not cause any bank to fail and Congress did not prohibit such conduct in Section 20.

The Board first interpreted the pivotal language in Section 20 as referring only to underwriting and not to brokerage activities in 1936 (22 Fed. Res. Bull. 51 n.1) (albeit in connection with the identical wording of Section 32 of the Glass-Steagall Act, 12 U.S.C. 78), and the Board has not modified that interpretation since. See 12 C.F.R. 218.1 n.1. As an aid to interpreting Section 20, the Board's regulation construing Section 32 is entitled to great weight by this Court. See *Northcross* v. *Board of Education*, 412 U.S. 427 (1973); *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980).

That the language in Section 20 plainly does not embrace brokerage services is demonstrated by this Court's treatment of the same language in Section 32 of the Glass-Steagall Act in *Board of Governors* v. *Agnew*, 329 U.S. 441 (1947). There the Court repeatedly described the statute as involving underwriting. Moreover, the Court would not have been obliged to decide whether the securities firm involved in that case was "*primarily* engaged" in the "public sale" of securities if that term included brokerage activities; virtually every securities firm is "primarily engaged" in some combination of underwriting and brokerage activities.

B.

Section 16 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh, is not relevant to deciding what bank holding companies may do in connection with securities. By its terms that section applies only to banks. It makes a mockery of the plain meaning rule for petitioner to argue, notwithstanding Section 16's direct reference to banks and its use of language fundamentally different from Section 20's in describing the securities activities open to banks, that the provision should be incorporated into Section 20 and thereby impose additional limitations not included therein. See *Russello* v. *United States*, No. 82-472 (Nov. 1, 1983). Moreover, nothing in the legislative history indicates that Congress intended these two sections to impose identical restrictions, and this Court already has held that the structure of the Act "reveals a congressional intent to treat banks separately from their affiliates." *ICI II*, 450 U.S. at 59 n.24.

C.

Even if, contrary to our prior contention, Section 16 does apply to bank holding companies, Schwab's brokerage activities are within the activities authorized by Section 16. Schwab purchases and sells securities "upon the order, and for the account of, customers, and in no case for its own account." 12 U.S.C. 24 Seventh. The refer-

ence to "customers" in the statute merely means that the bank must act as an agent and never as principal in the purchase and sale of stock. This is consistent with Congress's intention in 1933 to permit banks to purchase and sell securities "to the same extent as heretofore," S. Rep. 77, 73d Cong., 1st Sess. 16 (1933); banks had executed sales for persons who were not otherwise their customers prior to 1933.

The only support for petitioner's claim that Section 16 limits a bank's authority to sell stock as agent to customers of the bank's other services is that the Comptroller adopted this construction in 1936. The Comptroller of the Currency has now rejected the earlier interpretation that Section 16 contains an independent customer requirement. The Comptroller explained that the prior ruling was not compelled by the language of the statute, that the basis for the prior limitation was never explained and that in light of experience the old rule appeared to embody an unduly conservative approach not intended or ever ratified by Congress. Since the Comptroller fully explained the reasons for departing from the earlier rulings, and since that departure is clearly consistent with the statute, the Comptroller's present interpretation is entitled to deference by this Court. *American Trucking Ass'n* v. *Atchison, T. & S.F. Ry.*, 387 U.S. 397 (1967). Under the Comptroller's interpretation of Section 16, banks are clearly permitted to engage in discount brokerage activities; it follows, *a fortiori*, that a bank holding company may.

ARGUMENT

In 1975, for the first time in the long history of the New York Stock Exchange and the other smaller exchanges, the brokerage commission rates—the fees investors pay brokers to execute securities trades—were unfixed by an order of the Securities and Exchange Commission. See note 2, *supra*. The natural and expected consequence of the SEC's decision was the emergence of

the "discount brokerage firm" as a viable financial institution. What this case involves is the quintessential administrative responsibility—indeed the very raison d'etre for creating administrative agencies—to adjust and apply preexisting requirements and prohibitions in the statute an agency administers to new forms of commercial opportunity. With the benefit of an exhaustive record, the Federal Reserve Board has taken a hard look at the relationship between discount brokerage activities and traditional banking activities and concluded in a thoughtful and reasoned opinion that the former are so closely related to the latter that integrating those activities under the umbrella of a holding company will not blur the line that Congress drew in the Bank Holding Company Act between banking and other forms of commerce. In addition, the Board concluded that the new business of discount brokerage is not prohibited by the 50-year old ban on "public sales," in Section 20 of the Glass-Steagall Act, which was intended solely to keep bank holding companies and their nonbank subsidiaries out of the underwriting business.

Contrary to petitioner's charge (Pet. Br. 43-46), this case is not an example of an agency retreating from the task Congress assigned to it to maintain the integrity of banking and preserve its segregation from ordinary forms of commerce. The Federal Reserve Board has carefully and faithfully carried out the missions Congress assigned to it, and petitioner's vague assertions about faithless regulators based on actions of other administrative agencies in other contexts simply have no relevance to the Board's order in response to BankAmerica's application. The Board's interpretation of the statutes it administers is reasonable and the factual basis for its conclusions is not even disputed by petitioner. By any standard of judicial review of agency decision making, the decision below approving BankAmerica's application to acquire Schwab should be affirmed.

I. THE FEDERAL RESERVE BOARD PROPERLY CONCLUDED THAT DISCOUNT BROKERAGE SERVICES ARE CLOSELY RELATED TO BANKING WITHIN THE MEANING OF SECTION 4(c)(8) OF THE BANK HOLDING COMPANY ACT

Section 4(c)(8) of the Bank Holding Company Act of 1956 authorizes the Federal Reserve Board to permit bank holding companies to acquire substantial ownership interests in other companies if the Board determines that the acquired company's business is "so closely related to banking or managing or controlling banks as to be a proper incident thereto." 12 U.S.C. 1843(c)(8).[4] The Board's order approving BankAmerica's acquisition of Schwab and the recommended decision adopted by the Board contain detailed findings concerning the securities brokerage services now being provided by banks (J.A. 25a-36a; 129a-132a). Based on these findings the Board determined that Schwab's discount brokerage services are "operationally and functionally very similar to the

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[4] A bank holding company must satisfy two tests under Section 4(c)(8) of the Bank Holding Company Act in order to engage in nonbank activities under that section. First, the activity must be "closely related to banking." Section 4(c)(8) also establishes a second, so-called "proper incident" test, which requires a bank holding company to establish to the Board's satisfaction that its performance of the related nonbank activity "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices." 12 U.S.C. 1843(c)(8). See H.R. Rep. 91-1747, 91st Cong., 2d Sess. 21 (1970); *Ass'n of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549, 551-552 (7th Cir. 1978).

In its order approving BankAmerica's acquisition of Schwab, the Board concluded, based on extensive and detailed evidentiary findings, that the "proper incident" test was satisfied with respect to all of Schwab's activities (J.A. 133a-146a). Petitioner challenged those findings in the court of appeals, but the court concluded that they were "plainly reasonable" (J.A. 175a), and petitioner has not renewed its challenge on this issue in this Court.

types of brokerage services that are generally provided by banks" and that "banking organizations are particularly well equipped to provide" the kind of securities brokerage services offered by Schwab (J.A. 129a). Accordingly, the Board concluded that Schwab's discount brokerage activities satisfy the "closely related to banking" test of Section 4(c)(8) (J.A. 131a, 146a).[5]

Petitioner does not contend that the Board's findings are not supported by substantial evidence, but rather asserts (Pet. Br. 12-19) that the Board applied an erroneous legal standard in determining that Schwab's discount brokerage activities are "closely related to banking." To the contrary, the close functional and operational similarity test applied by the Board in this case is consistent with the language, legislative history and longstanding judicial and administrative interpretations of Section 4(c)(8), and therefore was properly upheld by the court of appeals.

A. The Language, Structure And Legislative History Of Section 4(c)(8) Indicate That The Board Has Discretion To Determine That A Bank Holding Company May Engage In Discount Brokerage Activities Through A Subsidiary

1. Congress made no attempt in the Bank Holding Company Act to designate what types of nonbanking activities it intended bank holding companies to be permitted to undertake or those it intended to prohibit; certainly nothing in the Act prohibits securities brokerage activities. Instead, it left those determinations to the discretion of the Board, and, contrary to petitioner's claim (Pet. Br. 13), the language and structure of Section 4(c) indicate that the authorization granted was intended to be more than a trivial one. Since the Act "requires divestment

[5] In its order, the Board also concluded that Schwab's margin lending, securities custodial, and account maintenance services satisfy the "closely related to banking" test based on findings that banks generally offer the same or functionally identical services (J.A. 132a-133a). These findings are not contested by petitioner.

only of nonbanking interests, the § 4(c)(8) exception would be unnecessary if it applied only to services that a bank could legally perform." *ICI II*, 450 U.S. at 64. Thus, Section 4(c)(8) must allow bank holding companies to enter into activities in which banks themselves may not. In addition, since Section 4 of the Act contains an independent exemption for performing services for subsidiary banks, see 12 U.S.C. 1843(c)(1)(C),[6] the nonbanking services embraced by Section 4(c)(8) must extend beyond operations that are essential or contribute significantly to the achievement of some preexisting banking function. Otherwise, Section 4(c)(8) would be rendered superfluous. Indeed, if Congress had intended for the nonbank activities to involve nothing more than essentially preexisting banking activities, it is difficult to understand why it would have bothered to adopt the "proper incident" test, which requires the Board to engage in a wide ranging inquiry into the benefits and adverse effects of permitting a particular bank holding company to enter a new field of closely related endeavor. Compare 12 U.S.C. 1843(c)(1)(C) (contains no proper incident requirement).

Section 4(c)(8) on its face is simply not susceptible to the crabbed interpretation of the Board's discretion petitioner proposes. Under a "normal reading" of the statute (see *ICI II*, 450 U.S. at 56), nonbanking activities that are "closely related to banking" must embrace at

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[6] The legislative history of the Act confirms that the authority granted bank holding companies by Section 4(c)(8) (then Section 4(c)(6)) to engage, after Board approval, in "closely related" nonbank activities, was intentionally broader than the servicing authority granted by Section 4(c)(1)(C). See S. Rep. 1095 (Pt. 2), 84th Cong., 2d Sess. 3 (1956). The Board has interpreted the Section 4(c)(1)(C) exemption as including companies that act "to *facilitate operations* of one or more of the subsidiary banks." *One-Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1211, S. 1664, et al. Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess., Pt. 1, at 141 (1970) (testimony of Arthur Burns) (emphasis added).

least those services performed by nonbanks that have a close operational and functional similarity to activities ordinarily performed by banks.

2. Although the legislative history "provides no real guidance as to the scope of the exception" in Section 4(c)(8) (*ICI II*, 450 U.S. at 56 n.20), it nevertheless makes plain that the Board was invested with a significant amount of flexibility in identifying the types of relationships that satisfy the "closely related" requirement of that section. See *id.* at 76 & n.58. Section 4(c)(6) of the original 1956 Act (now Section 4(c)(8))[7] authorized bank holding companies to engage in activities "of a financial, fiduciary, or insurance nature * * * which the Board * * * by order has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto and as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of this Act." 70 Stat. 137 (1956). The report of the Senate Committee on Banking and Currency accompanying the legislation explained (S. Rep. 1095 (Pt. 1), 84th Cong., 1st Sess. 13 (1955)):

> [T]here are many * * * activities of a financial, fiduciary, or insurance nature which cannot be determined to be closely related to banking without a careful examination of the particular type of business carried on under such activity. For this reason, your committee deems it advisable to provide a forum before an appropriate Federal authority in which decisions concerning the relationship of such activities to banking can be determined in each case on its merits.

In 1970, Congress amended Section 4(c)(8) in a manner that "[o]n its face * * * would appear to have

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[7] Section 4(c)(6) was renumbered as Section 4(c)(8) by the 1966 amendments to the Bank Holding Company Act. See 80 Stat. 238.

broadened the Board's authority to determine when an activity is sufficiently related to banking to be permissible for a nonbanking subsidiary of a bank holding company" (*ICI II*, 450 U.S. at 72-73 (emphasis added)). Congress deleted the words "the business of" from Section 4(c)(8) and thereby "eliminated the requirement that bank holding companies show a close connection between a proposed activity and an activity in which the holding company or its subsidiary already actually engaged. Thus, the 1970 amendment to § 4(c)(8) permitted bank holding companies to engage in any activities closely related to activities generally engaged in by banks." 450 U.S. at 73 n.51.[8]

This Court noted in *ICI II* that the 1970 amendments to Section 4(c)(8) "were not intended to cut back on the discretion afforded the Board," but rather to maintain "'maximum flexibility for the Federal Reserve Board to determine the activities in which a bank holding company and its subsidiaries may engage * * *.'" 450 U.S. at 58 n.23 (quoting 116 Cong. Rec. 42432 (1970) (remarks of Sen. Bennett)). "As Senator Sparkman stated regarding the conference agreement: 'We reached a deci-

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[8] In 1970, Congress also amended the Bank Holding Company Act expressly to prohibit tie-ins between banking and nonbanking services offered by bank holding company subsidiaries. See Section 106(b) of the Bank Holding Company Act Amendments of 1970, 84 Stat. 1766. See also 12 C.F.R. 225.4(c)(1). This amendment prohibits arrangements whereby the obtaining of credit or some other service from a banking subsidiary of a bank holding company is in any way tied to or conditioned upon obtaining any other credit or service from the bank's holding company or any of that holding company's bank or nonbank subsidiaries. The amendment is inconsistent with a construction of Section 4(c)(8), such as that urged by petitioner (Pet. Br. 15), that in effect *requires* a bank holding company applying for Board authorization under that Section to show that the proposed nonbank services would only be offered to "customers" utilizing the separate services of the holding company's subsidiary. See *National Courier Ass'n* v. *Board of Governors*, 516 F.2d 1229, 1239 (D.C. Cir. 1975).

sion that the whole thing ought to be flexible, that it ought to be lodged in the hands of the Federal Reserve Board to carry out the guidelines we set.' 116 Cong. Rec. 42429 (1970)." 450 U.S. at 76 n.58.

In this regard, the amendment was the product of Congress's recognition that it is "essential that banks and bank holding companies have the flexibility to engage in new types of bank-related activities that may be needed now and in the future if the financial needs of the people are to be met efficiently, competitively and at reasonable cost." 116 Cong. Rec. 31822 (1970) (remarks of Sen. Sparkman). See also *id.* at 32130 (remarks of Sen. Bennett); *Bank Holding Company Act Amendments: Hearings on H.R. 6778 Before the House Comm. on Banking and Currency*, 91st Cong., 1st Sess., Pt. 1, at 196 (1969) (remarks of William McChesney Martin, Jr.) (purpose of proposal is to "encourage innovation by * * * multibank holding companies in offering services to the public"). Thus, the Board's determination that bank holding companies may be permitted to engage in discount brokerage activities—a new commercial opportunity—because they are closely related to banking is precisely the kind of decision Congress envisioned the Board should make when it modified Section 4(c)(8) in 1970.

3. Remarkably, petitioner interprets (Pet. Br. 14-15) the legislative history of Section 4(c)(8) as completely repudiating the Board's analysis here. Petitioner's version of the 1970 amendments, however, involves a serious mischaracterization of what Congress clearly intended to achieve by those amendments and the standard the Board applied in this case.[9]

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[9] The other legislative materials relied upon by petitioner (Pet. Br. 13-14) are not persuasive evidence that Congress intended the Board's authority to be severely restricted. The report of the House Committee accompanying the original Act, H.R. Rep. 609, 84th Cong., 1st Sess. 16-17 (1955), is inapposite since the legislation reported by the House Committee contained *no* authorization for closely related nonbank activities. The language cited by petitioner

Prior to the 1970 amendments, the Board had interpreted the words "closely related to the *business* of banking" as requiring a "direct and significant connection" between the nonbank activities authorized by that section and the business operations of the applicant bank holding company's banking subsidiaries. See *Bank Holding Company Act Amendments: Hearings on H.R. 6778 Before the House Comm. on Banking and Currency*, 91st Cong., 1st Sess., Pt. 1, at 196, 199 (1969) (testimony of William McChesney Martin, Jr.); see also *One-Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1211, S. 1664, et al. Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 147 (1970) (testimony of Arthur Burns). The Board proposed that Congress amend the statute to liberalize its sweep by substituting a "functionally related to banking" standard. As the Chairman of the Federal Reserve Board explained, "one of the reasons we recommended that 'closely related' be changed to read 'functionally related' in the statute [was that] we wanted to avoid perpetuating the concept that a nonbank subsidiary's business must be related to the business of an affiliated bank." 116 Cong. Rec. 41959 (1970); *id.* at 42423.

Both the House and Senate passed bills that included the "functionally related" standard, but the Conference Committee deleted it. From this deletion petitioner infers that Congress intended to eliminate the Board's dis-

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refers instead to the exemption for servicing activities now codified at Section 4(c)(1)(C) of the Act, as contained in the House bill. Compare H.R. 6227, 84th Cong., 1st Sess. § 6(a) and (c) (1955); see note 6, *supra*. The remarks of Senator Capehart merely discuss the prohibition against nonbanking activities generally and do not purport to define the scope of the exception for activities determined by the Board to be "closely related to banking." 102 Cong. Rec. 6933-6939 (1956). Finally, the remarks of Senator Robertson cited by petitioner cannot be read too literally, because he also was of the view, shared by the rest of Congress, that as originally enacted, Section 4(c)(8) (then Section 4(c)(6)) was intended to give bank holding companies "liberal allowance" to engage in nonbanking activities. See 102 Cong. Rec. 6755 (1956).

cretion to consider in any way "functional relationships" between banking and nonbanking activities. But the conferees in both the House and the Senate in urging approval of their compromise relied upon the opinion of Chairman Burns that the Board's "objective" of having greater flexibility in making Section 4(c)(8) determinations would be served adequately if Congress simply removed the reference to "the business of" banking in the existing statute (116 Cong. Rec. 41959 (1970); *id.* at 42423), which Congress did. This history hardly supports an interpretation that Congress was narrowly confining the scope of activities the Board should consider under Section 4(c)(8). Compare *ICI II*, 450 U.S. at 73 ("[w]hether this [history] indicated that § 4(c)(8) was to have the same scope as it did under the 1956 Act is difficult to discern") with 116 Cong. Rec. 42429 (1970) (remarks of Sen. Bennett) ("the new language of section 4(c)(8) clearly gives the Federal Reserve Board broader discretion than it now has to make determinations of permissible activities").[10]

Moreover, petitioner's contention—that the close functional similarity standard employed by the Board is unwarranted—rests exclusively on the fortuity that the proposed amendment and the Board's approach both use the word "functional." But the "functionally related" to banking test proposed in 1970 is not the same as the "close operational and functional similarity" standard applied in this case. Arguably, the "functionally related" test in 1970 could have been understood as embracing nonbank activities bearing any relationship to functions performed by banks. By contrast, the test employed by the Board in this case is far more restrictive; the Board requires that the proposed nonbank activities either be

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[10] The amendment clearly was intended to free the Board from its prior use of a "direct and significant connection" test. 116 Cong. Rec. 41959 (1970); *id.* at 42423. Thus, petitioner's attempt (Pet. Br. 14-15) to incorporate that standard into Section 4(c)(8) is wholly inconsistent with the 1970 amendments to the Bank Holding Company Act.

performed by banks or be so operationally and functionally similar to banking functions that banks generally are particularly well equipped to perform them (J.A. 128a, 129a, 132a-133a). It simply does not follow from Congress's refusal in 1970 to substitute a bare "functionally related" test for the arguably more restrictive "closely related" test that any reliance by the Board on functional relationships in applying Section 4(c)(8) is henceforth impermissible.

B. The Board's Determination That Discount Brokerage Activities Are Closely Related To Banking Is Consistent With The Interpretation Of Section 4(c)(8) Adopted By This Court And By Every Court Of Appeals That Has Considered The Issue

The correctness of the test applied below is further demonstrated by the uniform judicial construction of the "closely related to banking" language of Section 4(c)(8). In *ICI II*, this Court deemed it sufficient for purposes of the "closely related" test to note that providing investment advisory services to registered investment companies was not "significantly different from the traditional fiduciary functions of banks," 450 U.S. at 55, and therefore satisfied the "plain language" of Section 4(c)(8). 450 U.S. at 58, 78. The Court made no finding that banks actually performed the activity there at issue; instead, the Court noted the fact that banks have traditionally managed customers' investments and, in particular, have administered common trust funds that are very similar in function to investment companies (450 U.S. at 55-56). The Court's opinion in *ICI II* contains *no* reference to any requirement that the activity "facilitated," "supported," or was otherwise "essential" or "directly connected" to the operations of any bank. The Board's legal analysis here is indistinguishable from the legal analysis of this Court in *ICI II*.[11]

[11] Petitioner attempts (Pet. Br. 16) to distinguish *ICI II* on the basis that the activity in that case "was a banking activity." But

Moreover, every court of appeals that has decided the issue—including the court below—has recognized that the Board may permit nonbanking activities under Section 4(c)(8) that have close operational or functional similarities to bank activities.[12] Indeed, in *National Courier*, 516 F.2d at 1237, the D.C. Circuit described three different types of close functional relationships to banking that the court considered to be within the legislative intent of Section 4(c)(8); the second of these—"[b]anks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service"—is an apt description of the relationship between banking generally and Schwab's discount brokerage securities activities.

In *National Courier*, the court upheld a determination that the provision of high speed transportation or courier services for "audit and accounting media of a banking or financial nature and other business records and documents used in processing such media" is "closely related to banking" and rejected precisely the kind of "facilitation" test petitioner urges here (516 F.2d at 1239):

> We do not think [the Board] has exceeded [its] discretion * * *. Authorization to provide courier services to banks and bank affiliates must carry

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that analysis is based on petitioner's characterization of the activity involved as "providing investment advice," which concededly had been done by banks for years. But *ICI II* involved creating and managing a closed-end investment company, which this Court held was permissible because it was operationally similar to giving investment advice.

[12] See *NCNB Corp.* v. *Board of Governors*, 599 F.2d 609, 613 (4th Cir. 1979); *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549, 551 (7th Cir. 1978); *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, 533 F.2d 224, 241 (1976), modified on other grounds, 558 F.2d 729 (5th Cir. 1977), cert. denied, 435 U.S. 904 (1978); *National Courier Ass'n* v. *Board of Governors*, 516 F.2d at 1237.

with it the authorization to provide the same services generally.

The court reasoned that to restrict a bank holding company courier service to dealing only with banks or their customers would be inconsistent with the Act's basic purpose to increase competition and eliminate tie-ins between bank and nonbank services. See *ibid.*[18]

Contrary to petitioner's claims (Pet. Br. 16-17), the opinion of the Fifth Circuit in *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, *supra*, also supports the use of a "close functional relationship" test as the appropriate legal standard. Indeed, the Fifth Circuit quoted approvingly the *National Courier* criteria applied by the Board and the court below in this case, stating "[w]e do not seek to be restrictive in determining what *types* of relationships to banking are cognizable under [§ 4(c)(8)]." 533 F.2d at 240-241 (emphasis added). Far from disapproving reliance on close functional similarities between traditional banking functions and nonbank activities proposed under Section 4(c)(8), the Fifth Circuit observed that there was "no evidence" that banks had provided

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[18] The *National Courier* court did set aside an interpretative ruling of the Board that would have authorized bank holding company-affiliated couriers to provide general courier service for non-financially related materials. Its reasoning was not, as petitioner implies (Pet. Br. 18), based on the necessity for a finding of a "direct and significant" connection between the authorized services and specific banking operations, but rather, the absence from the Board's ruling of any reasonably articulated close relation between the services authorized by the interpretative ruling and banking. See 516 F.2d at 1239-1240.

The court stated that Section 4(c)(8) requires the Board to "articulate the ways in which banking activities and the proposed activities are assertedly connected, and [to] determine, not arbitrarily or capriciously, that the connections are close." 516 F.2d at 1237. It is this test the D.C. Circuit applied in holding that the Board's authorization of general nonfinancial courier services exceeded the Board's authority under Section 4(c)(8). See 516 F.2d at 1241.

services functionally related to the general insurance brokerage service at issue in that case (533 F.2d at 241).[14]

C. The Board Has Consistently Interpreted Section 4(c)(8) As Permitting It To Consider Close Functional Similarities In Deciding Whether Banking And A Proposed Nonbanking Activity Are Closely Related

Since the 1970 amendments the Board has abandoned the requirement (previously implied under the "business of banking" test, see page 19, *supra*) that bank holding companies must demonstrate a direct and significant connection between proposed nonbanking activities and the operations of the banks owned by the applicant bank holding company. The Board has designated as permissible nonbanking activities having close operational and functional similarities to traditional activities of banks in general (relying in particular on the functional tests enunciated in *National Courier*) and has not required a showing that a particular activity has some direct, operational link to the actual business operations of specific banks.[15] Indeed, virtually all of the activities designated

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[14] The court of appeals in *Alabama Ass'n of Insurance Agents* considered (and with respect to certain activities found) other types of close relationships between banking and insurance activities authorized by the regulations under review in that case. On rehearing, the Fifth Circuit expressly noted its adoption of the "tests for closely-related-to-banking set out in *National Courier*." *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, 558 F.2d at 730.

[15] Compare, *e.g.*, *United Virginia Bankshares, Inc.*, 56 Fed. Res. Bull. 599, 601 (1970); *Dacotah Bank Holding Co.*, 56 Fed. Res. Bull. 469, 475 (1970); *In re Otto Bremer Co.*, 55 Fed. Res. Bull. 388, 391 (1969); *First Bank Stock Corp.*, 45 Fed. Res. Bull. 917, 930 (1959) (applying "direct and significant connection" test) with, *e.g.*, *BankAmerica Corp.*, 68 Fed. Res. Bull. 647, 648 (1982); *Orbanco Financial Services Corp.*, 68 Fed. Res. Bull. 198, 199

by the Board as permissible under Section 4(c)(8), such as mortgage and consumer lending and providing trust services and investment advice (Regulation Y, 49 Fed. Reg. 794, 826-828 (1984), to be codified at 12 C.F.R. 225.25)), could not be conducted practically by a bank holding company if those services could only be offered to banks or to customers having some identifiable connection with a bank.[16]

In its administration of the Act, the Board has found the standards it applied in this case fully adequate to implement Congress's intent that the Board prevent bank holding companies from entering into commercial areas that lacked a strong nexus to banking. See, *e.g.*, *BankAmerica Corporation*, 66 Fed. Res. Bull. 660, 661 (1980) (underwriting home loan life insurance); *NCNB Corp.*, 64 Fed. Res. Bull. 506, 507 (1978), aff'd, *NCNB Corp.* v. *Board of Governors*, 599 F.2d 609 (4th Cir. 1979) (underwriting credit-related property and casualty insurance and insurance claims adjustment); *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors*, 568 F.2d 549 (7th Cir. 1978) (travel agency); *First Commerce Corp.*, 58 Fed. Res. Bull. 674 (1972) (management consulting). These decisions disapproving various proposed nonbanking activities provide a complete answer to petitioner's asser-

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(1982); *JCT Trust Co.*, 67 Fed. Res. Bull. 635, 636 (1981) (applying "close functional similarity" test).

[16] Also without legal support is petitioner's novel suggestion (Pet. Br. 15) that a nonbank activity otherwise permissible under Section 4(c)(8) becomes impermissible under that section when it is "aggressively marketed to the public in general as an independent nonbank undertaking." To the contrary, the language and legislative history of that section reflect a congressional determination to encourage competition and innovation in nonbank businesses that are closely related to banking. See Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, § 103(4), 84 Stat. 1764-1765 ("benefits to the public, such as * * * increased competition"); 116 Cong. Rec. 42429 (1970) (remarks of Sen. Goodell); *id.* at 41957 (1970) (letter from Richard Kleindienst).

tion (Pet. Br. 18-19) that the test applied by the Board could flout Congress's intent by permitting bank affiliates to enter into such activities as the retail sales business since banks have used toasters as incentives to attract depositors in the past.

In sum, Section 4(c)(8) of the Bank Holding Company Act confers broad discretion upon the Federal Reserve Board to determine what types of relationships to banking will satisfy the "closely related to banking" test of that statute. Given the breadth of that discretion, the Board's consistent reference in this and other cases to the broad standards articulated in *National Courier* is certainly reasonable. The second *National Courier* standard, applied by the Board, the parties and the court below in this case, is a concise and intelligible articulation of a type of close relationship between kindred bank and nonbank services; it is consistent with the "plain language of the statute," and is certainly narrower than the "functionally related" test considered but not enacted in 1970. Along with the other two *National Courier* standards, this test has been uniformly and consistently quoted both by the courts of appeals and by the Board as an example of the type of relationship to banking that may satisfy the "closely related" requirement in Section 4(c)(8). Congress, having been informed of the Board's use of the *National Courier* standards,[17] has revisited Section 4(c)(8) without changing the closely related language[18] and, moreover, has rejected requests by petitioner and others to modify that

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[17] See *Competition in Banking Act of 1980: Hearings on S. 39, S. 38 and H.R. 2255 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 96th Cong., 2d Sess. 3, 4 & n.1 (1980) (testimony of J. Charles Partee) (*National Courier* standards "have come to be recognized as appropriate for determining whether a nonbanking activity is closely related to banking within the meaning of Section 4(c)(8)").

[18] See Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, Tit. VI, § 601, 96 Stat. 1536.

language.[19] It was accordingly entirely proper for the Board and the court of appeals to refer to those standards and apply them in determining that Schwab's discount brokerage services are "closely related to banking."

D. The Board Properly Exercised Its Discretion Under Section 4(c)(8) In Finding That Discount Securities Brokerage Is Closely Related To Traditional Bank Services

In light of the Board's special expertise and responsibility in regulating the commercial banking system, its determinations under the "closely related" test of Section 4(c)(8) should be accorded the "greatest deference" by the courts (*ICI II*, 450 U.S. at 56). The decision of the Board in this case is clearly deserving of that respect.

The Board acted reasonably in finding that the business of executing orders to buy and sell securities solely as the agent of customers is "closely related to banking" for purposes of Section 4(c)(8) (J.A. 129a-132a). Banks have traditionally performed this function for customers in a variety of contexts.[20] Indeed, Section 16 of the Glass-Steagall Act expressly authorizes banks to purchase and sell securities and stock for the account of customers. See *Investment Company Institute* v. *Camp* (*ICI I*), 401 U.S. 617, 624-625 (1970). ("No provision of

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[19] See *Bank Holding Company Legislation and Related Issues: Hearings on H.R. 2255, H.R. 2747, H.R. 2856, et al. Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance, and Urban Affairs*, 96th Cong., 1st Sess., Pt. 2, at 902, 904, 915 (1979) (testimony of John F. Donohue, Jr., on behalf of Securities Industry Association); cf. H.R. 2747, 96th Cong., 1st Sess. 3(a) (1979) ("so closely *and directly* related to banking * * * as to be a proper *and necessary* incident thereto" (emphasis added)).

[20] See generally SEC, *Final Report on Bank Securities Activities* (*SEC Final Report* (1977)); *Initial Report on Bank Securities Activities* (*SEC Initial Report* (1977)), *reprinted in Reports on Banks Securities Activities of the Securities and Exchange Commission*, Senate Comm. on Banking, Housing, and Urban Affairs, 95th Cong. 1st Sess. 1, 289 (Comm. Print 1977); *Brokerage and Related Com-*

the banking laws suggests that it is improper for a national bank * * * to purchase stock for the account of customers.")[21]

For many years, both before and after enactment of Glass-Steagall, many banks bought and sold all types of securities as agent of their customers, usually on an informal basis.[22] See pages 43-45, *infra*. In addition, as the Court recognized in *ICI II*, "[a]s executor, trustee, or managing agent of funds committed to its custody, a bank regularly buys and sells securities for its customers." 450 U.S. at 55.

The SEC's study of bank securities activities found (*SEC Final Report*, *supra*, at 121) that:

> [w]ith respect to the purchase and sale of securities for their managed accounts, bank trust departments are performing in many respects the same activities as are performed by retail brokerage firms. They are effecting transactions in securities for the account of others.[23]

Unlike retail discount brokers such as Schwab, which execute orders to buy and sell securities directly, banks

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mercial Bank Services: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs, 94th Cong., 2d Sess. (1976); H.R. Rep. 94-1193, 94th Cong., 2d Sess. 7 (1976).

[21] Since, as demonstrated below, this provision authorizes banks to provide retail brokerage services it necessarily follows that such services are "closely related to banking."

[22] Beginning as early as 1953, commercial banks offered a number of specialized services that enabled third parties to invest predetermined amounts of money in securities issued by an employer (Employee Stock Purchase Plans), in additional shares of securities already held by the third party (Dividend Reinvestment Plans), or in specific securities designated by the bank (Automated Investment Services). *SEC Initial Report*, *supra*, at 13, 15, 36-37, 54-59.

[23] Bank trust departments constitute some of the largest institutional investors in the securities markets and account for a significant percentage of daily trading volume. See *SEC Final Report*, *supra*, at 163-164.

traditionally have used brokers to execute trades, largely because incorporated commercial banks have historically been excluded from membership in securities exchanges. But banks often execute orders directly without the use of intervening brokers for securities not listed on an exchange, dealing directly with dealers making a market in the securities or with other institutions. See *SEC Final Report*, *supra*, at 122, 166-169. Moreover, where bank trading desks employ brokers to execute orders for securities, the banks exercise considerable discretion and expertise in selecting particular brokers to execute orders, making the same types of decisions, and utilizing the same types of facilities and personnel with the same training and expertise as brokers do in the actual execution of these orders. See *SEC Final Report*, *supra*, at 165-179.

Based on this evidence, the Board found that banks generally, by virtue of their extensive securities transactions experience, are particularly well-equipped to perform the "operationally and functionally very similar" brokerage services offered by Schwab (J.A. 129a, 131a). Accordingly, the Board's findings provide ample support for its conclusion that Schwab's brokerage activities are "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company. Compare *ICI II*, 450 U.S. at 56-58; *Alabama Ass'n of Insurance Agents* v. *Board of Governors*, 533 F.2d at 241; *National Courier Ass'n* v. *Board of Governors*, 516 F.2d at 1237.

II. THE GLASS-STEAGALL ACT DOES NOT PROHIBIT A BANK HOLDING COMPANY FROM ACQUIRING A DISCOUNT BROKERAGE COMPANY THAT EXECUTES SECURITIES TRANSACTIONS AS AGENT, UPON THE ORDER AND FOR THE ACCOUNT OF, RETAIL CUSTOMERS

In its order, the Board found that the acquisition by a bank holding company of a discount securities brokerage firm is consistent with the provisions of the Glass-Steagall Act that insulate commercial banking from investment banking (J.A. 147a-154a). The Board concluded that as a discount broker Schwab is not "en-

gaged principally in the issue, flotation, underwriting, public sale, or distribution" of securities within the prohibition of Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, which applies to affiliates of member banks of the Federal Reserve System (J.A. 147a-151a). Further, the Board found that the acquisition is not inconsistent with the purposes of the Glass-Steagall Act, since Schwab does not deal in securities with its own assets and does not have a promotional interest or a salesman's stake in the sale of any particular issue of securities (J.A. 147a-151a). The Board's interpretation is consistent with the plain meaning and intent of Section 20, as interpreted previously by this Court, and therefore should be upheld.

A. Discount Brokerage Is Not Among The Securities Activities Proscribed To Bank Affiliates By Section 20 Of The Glass-Steagall Act

1. It is axiomatic that "in determining the scope of a statute, one is to look first at its language." *North Dakota* v. *United States*, No. 81-773 (Mar. 7, 1983), slip op. 12; and cases cited therein. Section 20 of the Glass-Steagall Act provides (12 U.S.C. 377):

> [N]o member bank shall be affiliated * * * with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities.

Because it applies by its terms to affiliates of member banks, Section 20 is the most obviously relevant provision of the Act governing the permissible securities activities of bank holding companies and their nonbank subsidiaries. 450 U.S. at 50-59 n.24, 60-61 n.26.[24]

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[24] Since "affiliate" is defined in 12 U.S.C. 221a(b)(2) to include a corporation under common control with a member bank, Schwab would become "affiliated" with Bank of America, a member bank, within the meaning of Section 20 as a result of Schwab's acquisition by BankAmerica.

Schwab is engaged principally in buying and selling securities as agent or broker for its customers and, not to any material extent, for its own account (J.A. 127a).[25] It is undisputed that Schwab's securities brokerage activities do not constitute the "issue, flotation, underwriting * * * or distribution" of securities for purposes of Section 20. The only term in the list of prohibited activities that could possibly apply to Schwab's practices is the "public sale" of securities. But it is clear that public sale as used in Section 20 does not embrace mere brokerage activities as an agent.

In describing the securities activities bank affiliates are prohibited from performing, Section 20 makes no mention of "brokerage," the term generally employed to describe securities transaction services performed by an agent for a customer.[26] Moreover, since discount brokerage necessarily involves both the purchase and sale of securities for customers, the term "public sale" does not accurately describe that activity.

The specific context in which the term "public sale" appears in Section 20 conclusively establishes that the term is meant to refer to activities involving the existence of a salesman's stake or a promotional interest in the sale of particular securities. "Public sale" is used in conjunction with "issue," "flotation," "underwriting," and "distribution"—terms that everyone in the securities industry understands to refer to operations involving the marketing of new issues or the introduction of blocks of

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[25] Schwab acts as principal only on very infrequent occasions, when, for example, it purchases securities for a customer by mistake. Even if such transactions are of the type described in Section 20, they comprise only a miniscule part of Schwab's activities and are not an activity in which Schwab is "engaged principally" (J.A. 39a-40a, 72a). Petitioner does not base its analysis of Section 20 on this point.

[26] 2 L. Loss, *Securities Regulation* 1215 (2d ed. 1961) (a broker executes an order for securities as agent of his customer; a dealer in securities acts for his own account and not as agent for the customer).

particular securities to the public generally. Moreover, the term "public sale" is similar to the term "public offering," which conventionally refers to the promotion and distribution to the public of a new issue or large block of securities by an issuer or underwriter, usually with a securities firm acting not as agent but as principal.[27] "It is a familiar principle of statutory construction that words grouped in a list should be given related meaning." *Third National Bank in Nashville* v. *Impac, Ltd.*, 432 U.S. 312, 322 (1977).[28] This canon of statutory construction is particularly apt where, as here, it is undisputed that four of the five terms refer generally to the same activity; it defies common sense to assume that the fifth term was intended to have a radically different meaning. In sum, the text of Section 20 is completely contrary to petitioner's contention that the activities restricted by that section include securities brokerage services performed as agent. On the basis of the plain meaning of Section 20, by itself, the decision below should be affirmed.

2. A further indication of the meaning intended for the term "public sale" in Section 20 is the fact that the brokerage activities of banks and bank affiliates received virtually no attention during congressional consideration of the Act. Since the draftsmen of the legislation detailed those securities functions undertaken by banking organizations that were perceived by Congress to have been the cause of bank failures in the

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[27] See 1 L. Loss, *supra*, at 551; see generally *id.* at 159-172, 547-555.

[28] Even if, as petitioner asserts (Pet. Br. 38), the terms used in conjunction with "public sale" in Section 20 may include some promotional activities that are not conducted as a principal, all of these statutory terms connote the public promotion of particular issues of securities in which the promoter has a salesman's stake. The execution of transactions in securities upon the order of customers does not involve any such activity. Moreover, although as a remedial statute, the Act should be construed so as to effectuate its purposes, correct construction of its terms still must "rel[y] squarely on the literal language." *ICI II*, 450 U.S. at 65.

1930's, the absence of any mention of brokerage functions is significant. In 1933, Congress was concerned about banks acting for their own accounts—the "over-investment [by banks] in securities of all kinds" which led to "the funds of various institutions [being] so extensively 'tied up' in long-term investments." [29]

Representative Bacon described concisely the activities of banks during the late 1920's and early 1930's that had caused the bank failures and were therefore the focus of Congress's prohibitions in Glass-Steagall. In referring to bank affiliates, he explained (77 Cong. Rec. 3954 (1933)):

> [T]heir needs for more merchandise led them to participate in, underwrite, or originate a growing proportion of [securities]. The more they sold, the more new issues they sought to handle. And as this growth continued, the more bank credit they were forced to make available for the purchase of new securities.
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> In the era of high-pressure investment sales many unsound issues were offered and many found their way into the portfolios of the smaller banks in the agricultural States.

Because banks and their affiliates had acted in concert to manipulate the market through these underwriting activities, Congress passed the provisions of Glass-Steagall to "keep commercial banks out of the investment business and commercial credit out of speculative channels." 77 Cong. Rec. 3954 (1933) (remarks of Rep. Bacon). Mere brokerage activities of nonbanking affiliates were obviously not the focus of congressional concern in 1933.[30]

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[29] S. Rep. 77, 73d Cong., 1st Sess. 8 (1933).

[30] S. Rep. 77, *supra*, at 10. Accord, *Operation of the National and Federal Reserve Banking Systems: Hearings on S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d Sess., Pt. 7, at 1057-1063 app. (1931).

Furthermore, permitting bank holding companies to offer discount brokerage services through an affiliate will not produce the unsound banking practices and conflicts of interest that the Act was intended to avoid. There is no danger that the funds of BankAmerica's depositors will be invested in imprudent securities investments, *ICI*, 401 U.S. at 630, *ICI II*, 450 U.S. at 66, because Schwab buys and sells securities only as agent, not as principal. Likewise, since Schwab has no interest in the purchase or sale of any particular securities—its income depends solely on the volume of securities traded—there is no realistic likelihood that the Bank of America would make unsound loans to issuers in order to help market the issuers' securities or to investors to help them purchase specific securities. See *ICI I*, 401 U.S. at 631; *ICI II*, 450 U.S. at 66-67 n.38. In addition, although an affiliate's unsuccessful operation may damage public confidence in a bank, since Schwab has no promotional stake in any particular securities, the loss of customer goodwill or damage to Bank of America's reputation would be no different than if any other affiliate lawfully owned by BankAmerica or some other holding company failed. See *ICI I*, 401 U.S. at 631-632; *ICI II*, 450 U.S. at 66 n.38. Finally, mere brokerage activities do not create serious conflicts of interest. Schwab's personnel provide only one service—execution of securities trades as agent of their customers; Schwab lacks a "salesman's stake in a particular investment." 401 U.S. at 638. In sum, brokering securities simply does not create the kinds of hazards against which Congress intended Section 20 of the Glass-Steagall Act to guard.[31]

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[31] Petitioner's reliance (Pet. Br. 21) on passing references to brokerage *houses* in remarks of one congressman and in this Court's *ICI II* opinion is misplaced. Neither reference was made in a discussion of brokerage *activities*, and it was as true in the 1930's as it is today that many securities firms that provide brokerage services also underwrite or deal in securities—operations that

3. Any doubt concerning the Board's conclusion that "public sale" as used in Section 20 does not include brokerage activities can be dispatched on the basis of the Board's longstanding and virtually contemporaneous interpretation of the same language in Section 32, 12 U.S.C. 78, which is a closely related provision of the same Act. Section 32 is specifically addressed to the securities activities of member bank affiliates, and it prohibits individuals from serving in certain capacities for both member banks and business entities that are "primarily engaged in the issue, flotation, underwriting, public sale, or distribution * * * of * * * securities." In January 1936, the Board issued its Regulation R, implementing the provisions of Section 32, which provides (22 Fed. Res. Bull. 51 n.1, codified at 12 C.F.R. 218.1 n.1):

> A broker who is engaged solely in executing orders for the purchase and sale of securities on behalf of others in the open market is not engaged in the business referred to in section 32.[32]

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clearly are among the activities proscribed by Section 20. See *Board of Governors* v. *Agnew*, 329 U.S. at 445-446; 2 L. Loss, *supra*, at 1215; SEC, *Report on the Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker* 87 (1936) ("it might well be said that all commission houses * * * combine the broker and dealer functions"). In any event, Rep. Kopplemann was specifically concerned about the situation in which those responsible for "determin[ing] the type and character of the banks' investments are at the same time promoters and sellers" of securities. 77 Cong. Rec. 3907 (1933) (remarks of Rep. Kopplemann). A broker, such as Schwab, has neither a promoter's nor a salesman's interest in the sale of any particular issue of securities.

[32] As originally enacted in 1933, Section 32 prohibited interlocks between a member bank and a firm primarily engaged in the business of "purchasing, selling, or negotiating securities." 48 Stat. 194. In an opinion published in June 1934, the Board stated that the terms purchase and sale as used in that provision connote the passing of ownership to or from the persons making the purchases or sales and thus that an organization engaged solely in executing orders for the purchase and sale of securities on behalf of others "is not within the intent or language of the statute." 20 Fed. Res. Bull. 393. The Banking Act of 1935, ch. 614, § 307, 49 Stat. 709, revised Section 32 to its present form in order to conform the

The Board has never modified this interpretation of Section 32.[33] Since Sections 32 and 20 employ identical language, were enacted for the same purpose and as parts of the same statute, and, indeed, even deal with

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description of the securities activities covered in that section to other provisions of the Glass-Steagall Act. H.R. Rep. 742, 74th Cong., 1st Sess. 17 (1935). Contrary to petitioner's assertion (Pet. Br. 40 n.72), the Board's construction of Section 32 was brought to the attention of Congress prior to the 1935 amendment. 1934 Federal Reserve Board Ann. Rep. 58 (Board interpreted the original Section 32 as covering only "the underwriting and distribution of securities").

[33] In reliance on the Board's interpretation of Section 32, a number of well-known figures in securities brokerage firms served as directors of large member banks of the Federal Reserve System immediately following enactment of the Glass-Steagall Act and thereafter. Prior to Glass-Steagall, several members of private banking firms, such as J.P. Morgan & Co. and Brown Brothers Harriman & Co. were both commercial and investment bankers and served as directors of member banks in New York City. To comply with the Act, the firms divested their securities underwriting and dealing activities. They continued commercial banking and continued to conduct a commission brokerage business as members of the New York Stock Exchange and other exchanges. N.Y. Times, June 9, 1934, at 21, col. 3; 138 Com. & Fin. Chron., June 9, 1934, at 3869, col. 1 (1934). Members of these firms also continued to serve as directors of member banks. See, *e.g.*, 26 Am. Bankers Ass'n J. 12 (1934) (statement of Guaranty Trust Co. listing among its directors Thomas Lamont and George Whitney of J.P. Morgan & Co. and W.A. Harriman of Brown Brothers Harriman & Co.); *id.* at 45 (statement of New York Trust Co. listing among its trustees two Morgan partners and a Brown Brothers Harriman partner). That such open and public relationships between banks and firms engaged in the brokerage business continued after the enactment of Section 32 without comment or objection from anyone forcefully demonstrates that "public sale" as used in Section 32 was not intended to reach the business of a commission broker, especially since these interlocking relationships involved firms, such as J.P. Morgan, that had been a chief target of the Glass-Steagall Act. See *Stock Exchange Practices: Hearings on S. Res. 84 and S. Res. 56 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess., Pts. 1-2 (1933); 77 Cong. Rec. 3730 (1933) (remarks of Sen. Glass).

the same subject matter, the Board's longstanding interpretation that "public sale" in Section 32 excludes brokerage activities applies with equal force to the same term in Section 20. See *Northcross* v. *Board of Education*, 412 U.S. 427, 428 (1973); *Hargrave* v. *OKI Nursery, Inc.*, 646 F.2d 716, 720 (2d Cir. 1980).

Given the Board's expertise in reviewing the activities of holding companies and banks[34] and its longstanding and virtually contemporaneous determination that securities brokerage is not among the activities described in Sections 20 and 32 of the Act, "considerable respect is due [its] 'interpretation.'" *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 566 (1980). See also *FEC* v. *Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 31-32, 37-39 (1981); *Power Reactor Development Co.*

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[34] The Board, through the Federal Reserve Banks, examines, supervises and enforces applicable laws with respect to state-chartered member banks as well as bank holding companies. 12 U.S. 325, 504, 505, 1818(b) and (e), 1844, 1847. The Federal Reserve System also takes action to control the growth of reserves held by depository institutions, 12 U.S.C. 263, 461, and extends funds to member banks and other depository institutions, 12 U.S.C. 343, 352, 357, 461(b)(7).

In *ICI II*, this Court quoted with approval Justice Rutledge's description of the deference that is due the Board's construction of the Glass-Steagall Act in view of its "specialized experience" (450 U.S. at 56-57 n.21, quoting *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. at 450 (concurring opinion)):

> Not only because Congress has committed the system's operation to [the Board of Governors'] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all of its phases, I think their judgment should be conclusive upon any matter which * * * is open to reasonable difference of opinion. Their specialized experience gives them an advantage judges cannot possibly have, not only in dealing with the problems raised for their discretion by the system's working, but also in ascertaining the meaning Congress had in mind in prescribing the standards by which they should administer it. Accordingly their judgment in such matters should be overturned only where there is no reasonable basis to sustain it or where they exercise it in a manner which clearly exceeds their statutory authority.

v. *Int'l Union of Electrical, Radio and Machine Workers*, 367 U.S. 396, 408 (1961).[35]

The Board's conclusion that brokerage functions are not part of underwriting or the "public sale" of securities within the meaning of the Glass-Steagall Act has already been implicitly accepted by this Court in *Board of Governors* v. *Agnew*, *supra*. In *Agnew*, a divided court of appeals held that a securities firm (Eastman Dillon) engaged in underwriting and brokerage activities was not "primarily engaged" in any of the activities described in Section 32, because its brokerage activities, as opposed to its *underwriting* activities, constituted its most significant source of revenue. *Agnew* v. *Board of Governors*, 153 F.2d 785, 791 (D.C. Cir. 1946). In the court of appeals' opinion, both the majority and the dissent used the term "underwriting" to refer to all of the securities operations described in Section 32 and considered brokerage to be outside the activities described by that section (153 F.2d at 787, 795). Indeed, the majority noted that "[u]nderwriting and brokerage, although both concerned with securities, are vastly different operations" (*id.* at 790).

Reversing the court of appeals, this Court held that Eastman Dillon's underwriting activities were substantial enough to support the Board's conclusion that the firm was "primarily engaged" in activities described in Section 32. But in so holding, the Court started from the same premise as the court of appeals—that Eastman Dillon's brokerage activities were not within the scope of Section 32. 329 U.S. at 445 & n.3, 446. Indeed, when the Court described Section 32's scope it repeatedly characterized it as concerning "underwriting" (329 U.S. at

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[35] Deference to the Board's construction of the Glass-Steagall Act is also appropriate in this case because the Board has been vested by Congress with responsibility for enforcing the relevant statutory provisions. Section 20 authorizes the Board to assess civil money penalties for violations of its terms. Section 32 authorizes the Board to provide by regulation for exceptions to the management interlocks prohibition in that Section.

447, 448, 449). Had this Court believed, as petitioner now asserts, that Section 32 embraced an investment firm's brokerage activities, it would have been wholly unnecessary for it to decide the meaning of "primarily" in Section 32, because no one disputed that the largest part of the firm's revenue was derived from securities brokerage activities.

B. Section 20 Contains The Only Prohibition In The Glass-Steagall Act That Is Relevant To BankAmerica's Acquisition, As A Bank Holding Company, Of Schwab

Petitioner in its brief devotes almost no attention directly to Section 20 of the Glass-Steagall Act, virtually conceding that Section 20 read by itself does not prohibit BankAmerica's acquisition as a bank holding company of Schwab. Petitioner attempts (Pet. Br. 20-34), however, to shift the Court's attention to Section 16 of the Glass-Steagall Act, which by its terms only applies to *national banks* and permits them to engage in "purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers." 12 U.S.C. 24 Seventh.[36] Finding in this provision language that bears at least some slight resemblance to the services rendered by Schwab, petitioner asks the Court to decide this case without regard to Section 20's language, purpose and prior administrative interpretation.

We submit that Congress intended Section 20 to be the sole limitation on the activities of BankAmerica and that the distinct requirements of Section 16 are irrelevant to this case.[37] As this Court pointed out just this Term,

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[36] Although by its terms Section 16 applies only to national banks, Section 5(c) of the Glass-Steagall Act, 12 U.S.C. 335, provides that state member banks of the Federal Reserve System are subject to the same limitations and conditions that Section 16 imposes on national banks "with respect to the purchasing, selling, underwriting, and holding of investment securities and stock."

[37] Nor is there any basis for interpreting the language of Section 20 in light of Section 21(a) of the Glass-Steagall Act, 12 U.S.C. 378(a), which prohibits an organization "engaged in the business of issuing, underwriting, selling, or distributing," inter alia, secu-

"[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Russello* v. *United States*, No. 82-472 (Nov. 1, 1983), slip op. 6-7 (quoting, *United States* v. *Wong Kim Bo*, 472 F.2d 720, 772 (5th Cir. 1972)). See *North Haven Board of Education* v. *Bell*, 456 U.S. 512, 521 (1982); *United States* v. *Naftalin*, 441 U.S. 768, 773-774 (1979).[38]

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rities "to engage at the same time to any extent whatever in the business of receiving deposits." Neither BankAmerica nor Schwab receives deposits. Moreover, contrary to petitioner's assertion (Pet. Br. 35), the term "selling" in Section 21 does not mean brokerage activities; the Board interpreted that same term in the original Section 32 to exclude brokerage. See note 32, *supra*. Finally, it is quite clear that the reference to purchasing and selling investment securities in the proviso to Section 21 was intended to grant all depository institutions the authority to purchase and sell United States and municipal obligations, and thus the proviso provides no support for petitioner's claim regarding how Section 16 or Section 20 should be interpreted. See H.R. 742, 74th Cong., 1st Sess. 16 (1935); *Banking Act of 1935: Hearings on H.R. 5357 Before the House Comm. on Banking and Currency*, 74th Cong., 1st Sess. 662 (1935); *Banking Act of 1935: Hearings on H.R. 1715 and H.R. 7617 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 74th Cong., 1st Sess. 139 (1935).

[38] Moreover, petitioner's attempt to read Section 16 into Section 20 leads to unreasonable results that Congress could not possibly have intended. Section 20 uses the term "public sale" in a list of prohibited investment banking functions; the permission in Section 16 to purchase and sell securities for the account of customers is a separate authorization that is independent of that Section's general prohibition against dealing in and underwriting securities. Thus, if "public sale" in Section 20 is construed to encompass the purchase and sale of securities on behalf of customers, bank holding companies would be prohibited from offering *any* brokerage services (even the limited services petitioner concedes are permissible under Section 16 for banks) as a principal line of business. Moreover, this quandary cannot be escaped by reading into Section 20 petitioner's proposed limited authorization for brokerage services for preexisting banking customers, because affiliates of banks have no preexisting customers of banking services and are not limited to offering services to customers of their affiliated banks.

Petitioner's response (Pet. Br. 37) to this plain reading of the two provisions is that nothing in the legislative history indicates clearly that Congress intended for Section 20 to have a reach different from Section 16. But the language Congress used in the two provisions unmistakably indicates that they are not coterminous. The burden is therefore petitioner's to demonstrate that, notwithstanding their obvious differences, the provisions nevertheless should be read in identical fashion. Petitioner cannot satisfy that burden by citing (Pet. Br. 37) a single comment by one Senator indicating that the various provisions in the Glass-Steagall Act are "interrelated with a single purpose." 76 Cong. Rec. 1412 (1933) (remarks of Sen. Metcalf). No one disputes that Congress had a single purpose underlying its decision to adopt these provisions; the issue is whether it went about fulfilling that purpose by imposing identical restrictions on banks and bank holding companies.[39]

The language of the statute compels the conclusion that Congress intended Section 20's scope to be different from Section 16's. This Court has recognized as much in *ICI II*, *supra*. Noting that Section 20 authorizes bank affiliates to engage to some extent (less than principally) in securities activities that are flatly prohibited to banks, the Court concluded that the Act's structure therefore "reveals a congressional intent to treat banks separately from their affiliates" and to impose "a less stringent standard" on bank holding companies. *ICI II*, 450 U.S. at 59 n.24, 61 n.26. It is fully consistent with the statute's structure and Section 20's less stringent standard

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[39] If Senator Metcalf's remarks were sufficient to require the various provisions of Glass-Steagall to be read identically, then the use in Section 20 of the phrase "engaged *principally*" in underwriting activities would also have to be read out of the statute since no similar limitation appears in either Section 16 or 21. In *Agnew*, this Court concluded that the different qualifying phrases used in the various Glass-Steagall provisions were intended to "mark[] a distinction we should not obliterate" (329 U.S. at 448).

that bank holding companies be permitted to engage in a somewhat wider range of activities than are banks.[40]

C. Section 16 Of The Glass-Steagall Act Authorizes National Banks To Provide Discount Brokerage Services

The result is no different in this case even if we are incorrect that the plain meaning of Sections 16 and 20 necessarily establishes that they cover somewhat different activities and that Section 20's restriction on underwriting securities is the only prohibition relevant to a bank holding company. BankAmerica's proposed discount brokerage activities are authorized by Section 16's grant of power to a national bank "to purchas[e] and sell[] such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account." 12 U.S.C. 24 Seventh. Under an ordinary reading of Section 16, Schwab's brokerage activities are fully consistent with this authorization; Schwab acts solely as agent for its customers, based on their orders and solely for their accounts—not for Schwab's account—and the transactions are executed without recourse, since Schwab assumes no liability as maker, endorser or guarantor of the value or price of the security being bought or sold. Indeed, the Comptroller of the Currency, who has responsibility for administering Section 16's requirements for national banks, takes the view that national banks may offer discount brokerage services to the public. See *New Bank National Subsid-*

[40] The creation of a slightly less stringent standard for bank holding companies fully comports with the basic purpose of the Act to safeguard the depositors of banks because "[b]ank holding companies do not receive deposits." *ICI II*, 450 U.S. at 58 n.24. Moreover, the ability of banks in a holding company system to use depositors' funds in order to fund the operations of nonbank affiliates is severely curtailed by the restrictions of Section 23A of the Federal Reserve Act, 12 U.S.C. 371c, as added by the Glass-Steagall Act. The fact that Section 20 prohibits affiliates from engaging, as a principal line of business, in the kinds of securities functions that Congress believed to be too risky for banks to conduct at all still effectuates the purposes of the Act by eliminating the realistic danger that losses of an affiliate may seriously damage a bank.

iary Allowed to Offer Discount Brokerage Services, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,284, at 82-256 (Aug. 26, 1982), aff'd *Securities Industry Ass'n* v. *Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C. 1983), appeal docketed, Nos. 84-5026 and 84-5085 (D.C. Cir. Jan. 13 and Feb. 9, 1984).

1. Petitioner primarily argues (Pet. Br. 21-31) that the authorization to execute transactions "for the account of customers" implies a requirement that the individual using the brokerage service must previously have used other services offered by the bank. While this reading of the statute is consistent with limitations once imposed on brokerage services of national banks by the Comptroller of the Currency (see 1 Bulletin of the Comptroller of the Currency 2 (1936)), it is not supported by the language or legislative history of Section 16. Congress used the term "customers" in Section 16 merely to clarify the succeeding prohibition against a national bank's dealing in stock or other securities "for its own account," and to explain the preceding limitation, "solely upon the order, and for the account of," which would be unintelligible without the term "customers." 12 U.S.C. 24 Seventh. This interpretation is in accord with the basic purpose of that provision, which is to draw a bright-line distinction between impermissible transactions by a bank as a principal and permissible transactions by the bank as agent for others.[41]

In addition, the limited legislative history regarding Section 16 is fully consistent with the Comptroller's interpretation of "customer." The Congressional Reports on the Glass-Steagall Act explain that "national banks are to be permitted to purchase and sell investment securities for their customers *to the same extent as here-*

[41] Section 16 thus generally bars a bank from dealing in securities "for its own account" and limits a bank's purchase of securities "for its own account" to investment securities as defined in the statute, subject to certain limitations based on the bank's capital. The statute also excepts from this limitation purchases by a bank "for its own account" of certain types of government securities. 12 U.S.C. 24 Seventh.

tofore." S. Rep. 77, 73d Cong., 1st Sess. 16 (1933); H.R. Rep. 150, 73d Cong., 1st Sess. 3 (1933) (emphasis added). Prior to 1933, both national and state banks regularly bought and sold securities in an agency capacity. See *Blakey* v. *Brinson*, 286 U.S. 254 (1932); *McNair* v. *Davis*, 68 F.2d 935 (5th Cir.), cert. denied, 292 U.S. 647 (1934); *Mark* v. *Westlin*, 48 F.2d 609 (D. Minn. 1931); *Dyer* v. *Broadway Central Bank*, 252 N.Y. 430, 169 N.E. 635 (1930); *Block* v. *Pennsylvania Exchange Bank*, 253 N.Y. 227, 170 N.E. 900 (1930); *Le Marchant* v. *Moore*, 150 N.Y. 209, 44 N.E. 770 (1896); *Central National Bank* v. *White*, 139 N.Y. 631, 34 N.E. 1065 (1893); see also W.N. Peach, *The Security Affiliates of National Banks* 72-75 (1941); *Banks Allowed to Continue Stock Service*, The Bankers Magazine 699 (June 1934); [1924] Comp. of the Currency Ann. Rep. 12; R. Westerfield, *Banking Principles and Practice* 713-719; 1021-1039 (1921). Banks offering brokerage services did not require customers seeking to use such services to make a special deposit or draw a check to cover the purchase price. See *Blakey* v. *Brinson*, 286 U.S. at 259; *McNair* v. *Davis*, 68 F.2d at 936. Moreover, prior to 1933, banks provided brokerage services to the public generally, not just to individuals who enjoyed a preexisting customer relationship with the bank. See *Greenfield* v. *Clarence Sav. Bank.*, 5 S.W.2d 708 (Mo. Ct. App. 1928) (customer, not regular depositor, left $2,000 with bank solely for the purpose of purchasing bonds through the bank). See also, A. Smith, *Stock Market Service Comes High*, 21 Am. Bankers Ass'n J. 965 (Apr. 1, 1929) (observing that banks frequently "buy and sell securities for * * * customers and the public in general").[43]

[43] Although national banks, like other corporations, were excluded from membership in the stock exchanges at that time, various private bankers were members of the New York Stock Exchange when the Glass-Steagall Act was passed. Several announced that they were continuing their commission brokerage business after the Act's implementation date. See N.Y. Times, June 9, 1934, at 21, col. 3; 138 Com. & Fin. Chron., June 9, 1934, at 3869,

In light of the existing banking practices, it seems doubtful that Congress intended its reference to "customers" in Section 16 to serve as an insuperable obstacle to a bank performing brokerage services for someone who had not used the bank previously so long as the bank's brokerage services were performed strictly as agent and not for the bank's account. Certainly in rural areas in the 1930's, access to stock exchanges was limited and small town banks could and did perform an invaluable service by placing securities orders for people who lived away from commercial centers. See *Banking Act of 1935: Hearings on H.R. 5357 Before the House Comm. on Banking and Currency*, 74th Cong., 1st Sess. 663 (1935) (testimony of the Comptroller of Currency).

Moreover, limiting bank brokerage services to prior users of other services offered by the bank does not further any of the purposes of the Act. Petitioner's interpretation of customer does not preclude the provision of brokerage services altogether; it merely limits the extent to which the bank's services would be marketed. If it is not an unsound banking practice or conflict of interest to purchase and sell securities for preexisting customers, it is difficult to perceive how the evils to which the Act was addressed will result when a bank makes a stock transaction as agent for someone who has not rented a safe deposit box from the bank or opened a Christmas Club Account there.

The legislative history petitioner relies upon (Pet. Br. 23-27) does not suggest that Congress understood the term "customer" to mean preexisting customer or that it ever ratified such an interpretation by the Comptroller. The only references cited by petitioner (Pet. Br. 22-24) in connection with Section 16 are the Comptroller's statements made in 1934 and 1935, asking Congress to amend Section 16 to allow banks to act as agent for the purchase and sale of "stock" as well as other types of securities. Petitioner stresses that the Comptroller's state-

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col. 1; 4042, col. 2; 4210, col. 1. At least one private banker has continued to remain a member since then. See [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,284, at 86,258 (Aug. 26, 1982).

ments indicate that the bank will act solely "in an accommodation capacity." But that statement gives no clear indication of what he meant; the Comptroller's purpose in proposing the 1935 amendment to Section 16 was to make it easier for "the *public* located in communities removed from the money centers [to] dispos[e] of or purchas[e] securities in the form of corporate stocks for investment purposes." 1933 Comp. of the Currency Ann. Rep. at 11 (1934). It is difficult to perceive how this purpose would be served by the technical notion of accommodation petitioner proposes.[43]

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[43] The Comptroller did not expressly incorporate the idea of an independent customer relationship until his Report in 1936, well after Congress had acted. 1 Bulletin of the Comptroller of the Currency 2 (1936). Even if "accommodation" as used by the Comptroller in his testimony more clearly indicated that he intended that the services must be applied to a preexisting customer, Congress itself did not include "accommodation" as part of the statute. Thus, the discussion by the Comptroller does not indicate what Congress meant by customer in 1933 any more than the Comptroller's later administrative interpretation of the Act, which, as we discuss at pages 47-48, *infra*, is not dispositive on this issue.

Nor do the statements of Thomas F. Corcoran, cited by petitioner (Pet. Br. 25-27), provide any basis for concluding what Congress meant by its reference to "customers" in Section 20 of the Glass-Steagall Act. Mr. Corcoran was the general counsel of the Reconstruction Finance Corporation and one of the draftsmen of the Securities Exchange Act of 1934; he did not participate in drafting the Glass-Steagall Act, nor was he responsible for administering or interpreting that law. Moreover, Mr. Corcoran's brief remarks were merely a description of bank activities in the securities area and did not even purport to be a legal explication of the full powers of banks under Section 16.

Petitioner asserts (Pet. Br. 27) that since no one on the committees expressed disagreement with the statements, they necessarily represent Congress's view. The same committee, however, also listened to Richard Whitney, the President of the New York Stock Exchange, explain that "banks * * * customarily act *as agents* for their customers in buying and selling securities," and no one questioned this statement. *Stock Exchange Regulation: Hearing on H.R. 7852 and 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 154 (1934). As one commentator has noted, in light of the divergent views expressed on the point, "the role that Congress thought banks would play in the securities industry is unclear." Note, *A Banker's Adventures in*

2. Petitioner argues (Pet. Br. 28-31) in favor of its narrow construction of Section 16 that the Comptroller adopted, albeit without explanation, a similarly narrow interpretation in 1936. But this construction may have been based solely on the Comptroller's view of proper policy. The Federal Reserve Board, which is charged with administering Section 16 with respect to state member banks, did not share the Comptroller's view regarding the scope of bank brokerage services under that Section. In ruling on May 15, 1934 that the Glass-Steagall Act did not prohibit state member banks from performing stock brokerage services, the Board made no mention of any requirement of a preexisting customer relationship.[44]

Even assuming that the Comptroller's rule was based on his reading of the statute, petitioner's argument assumes that once an agency has interpreted a statute, that interpretation is frozen for all time, unless Congress enacts new legislation. Administrative law is not so inflexible. An agency "faced with new developments, or in light of reconsideration of the relevant facts and its mandate, may alter its past interpretation and overturn past administrative rulings and practices." *American*

Brokerland: Looking Through Glass-Steagall at Discount Brokerage Services, 81 Mich. L. Rev. 1498, 1533 n.168 (1983).

Finally, petitioner cites nothing in the Reports or debates indicating that banks were excluded from the definition of broker in the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(4), because of limitations on their activities imposed by Glass-Steagall. The legislative history of the 1934 securities legislation suggests that banks were exempted from the Act's coverage primarily because they were already subject to extensive supervision by federal and state banking authorities. See S. Rep. 792, 73d Cong., 2d Sess. 14 (1934).

[44] See 138 Com. & Fin. Chron., May 19, 1934, at 3364, col. 2. In a later publication of this ruling, the Board noted certain limitations (other than the preexisting customer requirement) placed on national banks' brokerage activities by the Comptroller of the Currency, but did not embrace those limitations in its own ruling with respect to state member banks. See 20 Fed. Res. Bull. 609 (1934).

Trucking Ass'n v. *Atchison, T. & S.F. Ry.*, 387 U.S. 397, 416 (1967). It remains, of course, incumbent upon the agency to provide a reasoned explanation for the change. See *Baltimore & A. R.R.* v. *Washington Metropolitan Area Transit Comm'n*, 642 F.2d 1365, 1370 (D.C. Cir. 1980).

The Comptroller's 1982 ruling was the culmination of previous rulings by the Comptroller and was made in response to the emergence of a new form of brokerage activity made possible by the unfixing of broker's fees.[45] In addition, the Comptroller explained that the earlier interpretations were not supported by any explanation or mandated by any specific language in the statute. In the Comptroller's view, the prior interpretation was overly cautious and completely unnecessary to protect against the hazards that had motivated Congress to enact Section 16, [1982-1983 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 99,284, at 86,255 (Aug. 26, 1982). These are clearly adequate bases for overturning his prior rulings and thus the Comptroller's more recent interpretation, which is itself reasonable, is entitled to respect by this Court. Under that interpretation, it is undisputed that Schwab's activities, even if performed by a national

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[45] Actually, the Comptroller's relaxation of the restrictions initially imposed on national banks' brokerage activities began much earlier. As the Comptroller stated in 1974, summarizing the change in agency policy [1973-1978 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 96,272, at 81,358 (June 10, 1974)):

> The office position from 1936 to 1957 was that it was inconsistent with the idea of an "accommodation" service for a bank to make a profit on such service. These old rulings did not reveal the rationale for concluding that a bank service, expressly authorized by Congress, could not be marketed in the usual fashion. This view, like many others expressed by bank regulators, in the immediate post-depression decades, was designed to be ultra-conservative and to confine banks as narrowly as possible in their activities. However, in this regard, the office apparently went further in the direction of conservatism than did the Congress, since neither the word nor the idea of the "accommodation" limitation appears in the statute or in any committee or floor comments.

bank directly, are not prohibited by Section 16. See *Securities Industry Ass'n* v. *Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C. 1983); *New York Stock Exchange* v. *Smith*, 404 F. Supp. 1091 (D.D.C. 1975), vacated as moot, 562 F.2d 736 (D.C. Cir. 1977), cert. denied, 435 U.S. 942 (1978).

3. Finally, petitioner argues (Pet. Br. 31-34) that it would violate the "without recourse" restriction in Section 16, if banks were allowed to engage in discount brokerage services. Schwab does not, however, assume any liability as maker, endorser or guarantor of any of the securities it buys or sells for its customers, which is the commonly understood meaning of that term. See G. Munn & F. Garcia, *Encyclopedia of Banking and Finance* 994 (8th ed. 1983); 2 R. Anderson, *Uniform Commercial Code* § 3-414:6, at 995 (2d ed. 1971) ("The words 'without recourse' have a fixed meaning; they operate to disclaim the liability of an endorser," *i.e.*, the contingent liability to pay the principal amount of the instrument at maturity.) Petitioner argues (Pet. Br. 31-34) that "without recourse" in this context must mean that the bank cannot incur any liability to anyone in connection with its execution of the purchase or sale of securities by a customer. Since Schwab is liable nominally to third parties if Schwab's customers fail to deliver funds due for purchases of securities they have ordered, petitioner concludes (Pet. Br. 31-34) that the sale is not without recourse. Petitioner asserts that this view is supported by this Court's decision in *Awotin* v. *Atlas Exchange National Bank*, 295 U.S. 209 (1935).

The contention is completely without merit. In *Awotin*, the bank had agreed to repurchase bonds at a set price, thus providing a clear guaranty to the purchaser. The bank refused to make good the guaranty and the purchaser sued. In response to the argument that the bank's authority to sell bonds was limited by the "without recourse" requirement, the purchaser argued that the technical form of the transaction did not involve an endorsement on the paper itself, which was the ordinary way that commercial paper is guaranteed. The Court

rejected this hypertechnical interpretation, holding that the obvious intent of Congress was to prohibit banks from holding purchasers or sellers harmless from losses they may incur because of market changes. 295 U.S. at 212.

Petitioner's contention totally distorts *Awotin*. It is petitioner who is attempting to avoid the obvious intent of the statute by devising a technical form of liability that has no relationship to the "hold harmless" problem that Congress intended to avoid by requiring banks to sell or purchase stock without recourse. Schwab's very limited exposure to liability from occasional customer error bears no resemblance to the catastrophic liability a bank could incur by agreeing to protect purchasers of securities from risks in the market, which was the sole focus of Congress's concern in adopting the without recourse limitation in Section 16. See *Awotin* v. *Atlas Exchange National Bank*, 295 U.S. at 211-212.[46] Indeed, the type of liability to the seller that petitioner cites could arise in any transaction when a bank buys or sells securities for a customer, and in effect would read the authorization to buy and sell securities for customers out of the statute. Under any reasonable construction of the without recourse limitation, Schwab's brokerage services are permissible under Section 16.

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[46] Interpreting "without recourse" as limited to an actual assumption of the investment risk does not, as petitioner claims (Pet. Br. 33 n.60), render the phrase superfluous. It still means that the bank will not be permitted to risk its resources in order to create a market for a customer who is having difficulty finding a buyer for a particular security.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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